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SUBJECT: NORTHERN ITALIAN "DISTRETTI" FACE THE GROWING
CRISIS

¶1. (SBU) Summary: Across Italy's industrial northern heartland, we've heard the same message with respect to the economic crisis in recent weeks: we're holding on, but won't last forever. Northern Italy's economy is dependent on clusters of "distretti," each with dozens of small firms that produce one thing, largely for export. As export markets have sagged, many of these "distretti" have suffered. Fortunately, credit still seems available for smaller firms with good ties to their local banks. Also, small and medium-sized firms are flexible enough to make adjustments (to their labor force or with innovation) to keep afloat in hopes of waiting out the tough times. The real concern is that the demand slump extends into next year when the worst-hit "distretti" may start to go under. This could potentially cause serious localized unemployment problems, and a political backlash against the central government, in cities across northern Italy. End summary.

Distressed "Distretti"

¶2. (U) To compile a snapshot of how the economic crisis is starting to bite in the industrial heartland of Italy, the Consul General recently traveled to Udine (in Friuli), Parma (Emilia Romagna), and Verona (Veneto). Rather than hosting a small handful of large employers, Italy's north is home to a number of "distretti") concentrations of dozens of export-oriented small and medium-sized enterprises (SMEs) focused on one industrial sector.

¶3. (U) The primary message that came through from our various meetings was that the situation is worrisome for nearly all the "distretti") we spoke primarily with ones that produced foodstuffs, furniture, textiles, and steel products. According to a trade association in Udine, already five percent of SMEs in its area of coverage have gone bankrupt. However, the consensus was that things had not yet become disastrous.

Good Products, No Buyers

¶4. (U) Considering the export nature of the "distretti," the number one topic on the minds of businesspeople and local officials was the perilous condition of traditional overseas markets in Europe, the United States, and Asia. As the level of exports) especially to the EU 27) continues to dive nationwide these firms are questioning their ability to replace lost international consumption with increased domestic purchases.

¶5. (U) One producer of fabrics for use in the automobile industry said that orders were still being fulfilled, but that buyers in Europe and the United States were unable to pay the invoices. A specialty steel producer told us that his order books were still OK, but only for a scant few

months into the future. On a more positive note, producers of wine in Veneto and Friuli told us that their sales were still decent, but that sales of high-end wines were down. Many makers of foodstuffs (pasta, olive oil, Parma ham, and San Daniele prosciutto from Udine) said they were actually looking to expand their international market presence. The one thing they feared was an uptick in protectionist sentiments in favor of domestic agricultural interests.

¶6. (U) Indeed, the inconsistent impact of the crisis across various export sectors is, thus far, a good sign for whole regions) though not for the smaller, undiversified "distretti" within a region. Recent data released for Lombardy, which can be extrapolated to some degree for the regions we visited, showed that those "distretti" producing things like foodstuffs, machines, and pharmaceuticals were actually prospering. Meanwhile, those relying on textiles, wood and woodworking, and vehicles were suffering inordinately. Likewise, those who had primary export markets in the United States and Asia were much better off than those who looked mostly to consumers in Europe.

Small is Better

¶7. (U) Another area of concern for the entrepreneurs with whom we spoke was financing. A senior banker at a large national institution here in Milan claimed that his bank is still offering loans and that the problem is more of demand (no sales so companies don't need to expand) than supply of credit. Outside of Milan we heard essentially the same message. Industrial associations and individual

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entrepreneurs told us that, for now at least, they can still rely on longstanding relationships with small, regional banks for infusions of credit. However, entrepreneurs) even those with medium-sized firms) told us they were reluctant to take on additional debt burden (or take out a loan for the first time), preferring to get through these lean times using built-up savings and creative workarounds.

¶8. (U) In fact, many pointed to the adaptability of SMEs, compared to their larger contemporaries, as a potential saving grace for their "distretti." Because these firms have more flexibility in adjusting their staffing, they can reduce costs more easily than larger firms. However, none predicted major spikes in unemployment as SME representatives were reluctant to fire skilled employees. Since these "distretti" are so focused on one area of production, someone laid off (rather than placed in temporary "cassa integrazione" to which most of these smaller firms have no access) would likely have to leave town to find work, and thus not be available when and if the company wanted to hire them back.

¶9. (U) SMEs are also better able, funding permitting, to innovate to improve productivity. A research center in Friuli, together with the University of Udine, for example, is working with entrepreneurs producing chairs (a key local "distretto") to rationalize their production. One trade association told us they hoped, in fact, that the economic crisis would provide a spark to encourage local SMEs to merge or otherwise become more efficient.

Comment: Approaching the Waterfall

¶10. (SBU) Most of our entrepreneur contacts tell us they are getting by for now and aren't planning anything drastic. However, even the most optimistic said they can't last in such a state for much longer. Should the crisis extend much beyond 2009, we would expect the hardest-hit "distretti" to start failing) a phenomenon that would hollow out towns that rely on this undiversified model, and make the economic crisis increasingly a political one for Rome. People with whom we spoke were very supportive of attracting foreign investment as a way to help reposition the "distretti" to be more competitive in difficult times. However, there was

general pessimism that the central government in Rome would react to the north's economic woes by improving the nation's poor investment climate.

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